**SMITH (HER MAJESTY'S INSPECTOR OF TAXES)**

**v.**

**SCHOFIELD**

HOUSE OF LORDS
LORD TEMPLEMAN, LORD GOFF OF CHIEVELEY, LORD JAUNCEY OF TULLICHETTLE, LORD MUSTILL, LORD WOOLF
11 MARCH 1993

***REVENUE LAW: Taxation - Capital gains tax - Disposal after 1965 of assets acquired before 1965 - Chargeable gains - Computations - Apportionment of gains to ascertain chargeable gains - Deduction of indexation allowance - Whether before or after apportionment - Capital Gains Tax Act 1979, Finance Act 1982.***

This appeal concerned the amount of capital gains tax to be paid by the taxpayer in respect of her disposal of two pieces of furniture in the fiscal year 1986/87.

Mrs. Schofield acquired a Chinese cabinet and a French mirror on the death of her father in 1952. Their market value then was £250. Mrs. Schofield sold them in 1987 for £15,800, receiving £14,338 after deduction of expenses, with the result that the difference between the market value in 1952 and the net sum which she received was £14,088. She was assessed to capital gains tax in the sum of £266.70.

Section 86(1) of the Finance Act 1982 as amended provides that s. 86 will apply to any disposal after 6 April 1965, and s. 86(2) provides that the amount of gain, which is to be the unindexed gain, should be as computed in accordance with Chapter II of Part II of the Capital Gains Tax Act 1979. In this case, the amount of the unindexed gain accruing on the disposal, after deduction of expenses, was £14,088.

Section 86(4) of the 1982 Act provides for an allowance, referred to as the indexation allowance, to be set against the unindexed gain so as to arrive at the gain for the purposes of the 1979 Act. The indexation allowance computed and agreed in the present case was the sum of £2,640 and Mrs. Schofield was treated as if the gain on the disposal was £11,448, not £14,088.

As Mrs. Schofield had owned the relevant assets on 6 April 1965, by virtue of s. 28(3) of the 1979 Act the provisions of Schedule 5 applied to restrict the amount of the chargeable gain. By paragraph 11 of Schedule 5, only so much of any gain accruing on the disposal as was under that paragraph to be apportioned to the period beginning 6 April 1965 was to be a chargeable gain.

The issue between the parties was whether the indexation allowance fell to be applied to the whole gain accruing between the date of acquisition and the date of disposal, or only to that part which was, by paragraph 11, apportioned to the period after 6 April 1965. That is, whether it was the indexed sum of £11,448 which was to be taken as the gain that must be apportioned for the purposes of the Act of 1979, the amount apportioned on this basis being £7,189, as agreed, which became liable to tax, or whether it was the unindexed sum of £14,088 which must be apportioned, the sum thus apportioned being £8,864, and the indexation allowance only then deducted from it, leaving the sum of £6,224 which was liable to tax, in which case Mrs. Schofield would not be liable to any tax at all.

**Held:**

**[1]** The correct approach was that Mrs. Schofield made an unindexed gain of £11,448 by the deduction of the indexation allowance. The sum of £11,448 was the gain for the purposes of the Act of 1979, and it was the gain which must be apportioned under paragraph 11 of Schedule 5 in order to produce a chargeable gain which was liable to tax. The indexation allowance is deductible from a gain and not from a proportion of a gain. Nor is it deductable from a chargeable gain. A taxpayer pays tax on chargeable gains.

**[2]** The sum of £7,189 was the chargeable gain made on the disposition by Mrs. Schofield, and capital gains tax in the sum of £266.70 was leviable on the basis of that chargeable gain.

*[Appeal allowed].*

**Case referred to:**
*IRC v. Joiner [1975] 1 WLR at p. 1711* ***(refd)***

**Legislation referred to:**
Capital Gains Tax Act 1979, ss. 1(1), 2(1), 4(1),28(1)(2)(3), 29, 30, 32(1)
Finance Act 1965, s.22(9), (10)
Finance Act 1982, ss. 86(1)(c), (2)(a), (4), 87(2)
Finance Act 1985, s. 68(1)(4), 86

**JUDGMENT**

**Lord Templeman**

My Lords,

Section 1 of the Capital Gains Tax Act 1979 provides, so far as material, that:

> (1) Tax shall be charged ... in respect of capital gains, that is to say chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets.

In Chapter II of Part II of the Act, s. 28 provides as follows:

> (1) The amount of the gains accruing on the disposal of assets shall be computed in accordance with this Chapter, and subject to the other provisions of this Act and ss. 86 and 87 of the Finance Act 1982.
>
> (2) Every gain shall, except as otherwise expressly provided, be a chargeable gain.
>
> (3) Schedule 5 to this Act (which restricts the amount of chargeable gains accruing on the disposal of assets owned on 6 April 1965) shall have effect.

Mrs. Schofield acquired assets in 1952 and sold them in 1987 for £15,800. After deduction of expenses the amount of the gain accruing on the disposal was £14,088.

Section 86(1) of the Finance Act 1982 as amended provides that s. 86 will apply to any disposal of an asset which occurs on or after 6 April 1982. Section 86 applies to the disposal by Mrs. Schofield in 1987. Section 86(2) provides that:

> In relation to a disposal to which this section applies -
>
> (a) 'the unindexed gain ...' means the amount of the gain ... on the disposal computed in accordance with Chapter II of Part II of the Capital Gains Tax Act 1979 ...

The amount of the gain on the disposal made by Mrs. Schofield was £14,088 and that is therefore the amount of her unindexed gain.

Section 86(4) made provision:

> ...for an allowance (... referred to as 'the indexation allowance') which, on a disposal to which this section applies, is to be set against the unindexed gain . . . so as to give the gain . . . for the purposes of the Capital Gains Tax Act 1979 as follows, -
>
> (a) if there is an unindexed gain. the indexation allowance shall be deducted from the gain ...

The indexation allowance computed and agreed in the present case is the sum of £2,640. Accordingly the sum of £2,640 must be set against the unindexed gain of £14,088 in order to give the gain for the purposes of the Act of 1979. Mrs. Schofield must be treated as if the gain on the disposal was not £14,088 but £11,448.

Mrs. Schofield owned the relevant assets on 6 April 1965 so that by virtue of s. 28(3) of the Act the provisions of Schedule 5 must be applied.

By paragraph 11 of Schedule 5:

> (2) On the disposal of assets by a person whose period of ownership began before 6 April 1965 only so much of any gain accruing on the disposal as is under this paragraph to be apportioned to the period beginning 6 April 1965 shall be a chargeable gain.

The sum of £11,448 was the gain for the purposes of the Act of 1979 and it is that gain which must be apportioned. The amount apportioned to the period beginning with 6 April 1965 on that basis is agreed to be £7,189, accordingly the sum of £7,189 becomes the chargeable gain made on the disposition by Mrs. Schofield and capital gains tax is leviable on the basis of that chargeable gain.

On behalf of Mrs. Schofield it was argued that the gain of £14,088 must be apportioned under Schedule 5. The part thus apportioned on that basis to the period beginning with 6 April 1965 is £8,864. If the argument is right then paragraph 11 of Schedule 5 stipulates that it is the sum of £8,864 which is the chargeable gain. Then according to the argument there must be deducted from the chargeable gain of £8,864 the indexation allowance. That leaves just £6,224 which Mrs. Schofield must bring into account in the computation of her capital gains tax liability.

My Lords, paragraph 11(2) of Schedule 5 provides that only the amount of any gain accruing on a disposal and apportioned to the period beginning 6 April 1965 shall be a chargeable gain. If the indexation allowance is deductible from the amount apportioned under

paragraph 11(2) the allowance is deductible from a chargeable gain and part of a chargeable gain escapes tax in breach of section 1(1) of the Act.

The correct approach is that Mrs. Schofield made a gain of £14,088 on the disposal. The indexation allowance reduces that gain of £14,088 to a gain of £11,448 for the purposes of the Act. That gain must be apportioned under paragraph 11 of Schedule 5 in order to produce a chargeable gain which is liable to tax. The indexation allowance is deductible from a gain and not from a proportion of a gain. The indexation allowance is deductible from a gain and not from a chargeable gain. A taxpayer pays tax on chargeable gains.

The Court of Appeal reached a different result and I would allow the appeal.

**Lord Goff Of Chieveley**

My Lords,

For the reasons set out in the opinions of Lord Templeman, Lord Jauncey of Tullichettle and Lord Woolf, I agree that this appeal should be allowed.

**Lord Jauncey of Tullichettle**

My Lords,

This appeal concerns the amount of capital gains tax to be paid by the taxpayer in respect of her disposal of two pieces of furniture in the fiscal year 1986/87. The taxpayer inherited the two pieces, a Chinese cabinet and a French mirror, on the death of her father on 19 April 1952. It was agreed that their combined market value at that date was £250 and as at 31 March 1982 was £10,000. She sold the two pieces at auction on 10 February 1987 for £15,800 and after deduction of the auctioneer's commission and other incidental expenses she received £14,338 with the result that the difference between the market value on 19 April 1952 and the net sum which she received was £14,088. She was assessed to capital gains tax in the sum of £266.70. If her contentions are correct that assessment would be reduced to nil. On appeal against the assessment Mr. D. C. Potter QC, sitting as a special commissioner, allowed the appeal. The Revenue appealed and Hoffmann J. allowed their appeal. The Court of Appeal in turn allowed the taxpayer's appeal. Although the sum involved in this appeal is very small your Lordships were informed that this was a test case chosen because of the simplicity of the facts and that there were many similar cases involving a very large sum of money whose results were likely to turn upon the decision in this case. It should be pointed out that the law applicable to this appeal was changed in the Finance Act 1988 so the problem which has arisen cannot arise in relation to gains accruing on disposals on or after 6 April 1988. Although the facts are simple the resolution of the problem cannot be so described.

Capital gains tax, in its present form, was introduced by Part III of the Finance Act 1965 and all existing provisions of that Act and subsequent Finance Acts were consolidated in the Capital Gains Tax Act 1979 ("the Act of 1979"). For the purposes of this appeal I shall refer only to the provisions of the latter Act. Section 1(1) thereof provided:

> 1. (1) Tax shall be charged in accordance with this Act in respect of capital gains, that is to say chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets(a).

Section 4 provided that the tax should be charged on the total amount of chargeable gains accruing to the taxpayer in the year of assessment and chapter II dealt with computation of gains. Schedule 5 was entitled "Assets held on 6 April 1965" and dealt in particular with Quoted Securities in Part I, Land Reflecting Development Value in Part II and Other Assets in Part III. All the relevant provisions dealing with these matters were reenactments of similar provisions in the Act of 1965. In the case of Quoted Securities and Land Reflecting Development Value a taxpayer subsequently disposing of either is assumed to have sold them and immediately reacquired them at their market value on 6 April 1965. Thus the value at that date will be the starting point for computing any gain in respect of which the taxpayer may thereafter be assessable to tax. It is in my view clear that Parliament was concerned that the tax should not operate retrospectively on gains which had accrued prior to its introduction and indeed this was apparently made clear by Ministers when introducing the Bill. In

the case, however, of Other Assets whose value at 6 April 1965 was not readily identifiable two alternatives were provided in Schedule 5. Paragraph 11 was in, *inter alia*, in the following terms:

> 11. (1) This paragraph applies subject to Parts I and II of this Schedule.
>
> (2) On the disposal of assets by a person whose period of ownership began before 6 April 1965 only so much of any gain accruing on the disposal as is under this paragraph to be apportioned to the period beginning with 6 April 1965 shall be a chargeable gain.
>
> (3) Subject to the following provisions of this Schedule, the gain shall be assumed to have grown at a uniform rate from nothing at the beginning of the period of ownership to its full amount at the time of the disposal so that, calling the part of that period before 6 April 1965, P, and the time beginning with 6 April 1965 and ending with the time of the disposal T, the fraction of the gain which is a chargeable gain is

$$\frac{T}{P + T}$$

However. paragraph 12 gave the taxpayer the option of electing for valuation at 6 April 1965 instead of adopting the paragraph 11 formula.

The sub-paragraphs of paragraph 11 to which I have referred constituted in my view a rough and ready method of avoiding retrospectivity in relation to assets whose value was not readily ascertainable. They saved trouble and expense both to the taxpayer and to the Revenue in seeking to establish the market value of a particular asset at a date which might be years before that on which the valuation was required. It was not intended to provide an accurate guide as to the value of a particular asset on 6 April 1965 because it is inherent in the formula that a figure arrived at on that date depends upon the value at the date of disposal which may be many years thereafter. What the formula does do is to take the entire gain from the date of acquisition or from 6 April 1965, whichever is later, to the date of disposal and apportion that part which is chargeable to tax and that part which is not, thereby ensuring that where a gain has accrued over a period starting before 6 April 1965 that fact is reflected in the apportionment. The formula produces a result which is comparable in principle to that which is achieved by the election for a valuation on 6 April 1965 but which cannot bear comparison in detail for the reason which I have already stated. Where the greater part of the increase in true value of an asset has taken place prior to 6 April 1965 it will be to the taxpayer's advantage to elect valuation at that date but where such greater part has occurred since 6 April 1965 ,it will be more advantageous to him to adopt the paragraph 11 procedure. This demonstrates the arbitrary nature of the formula. Nevertheless it seems probable that in 1965 Parliament did not contemplate the dramatic rise in inflation which took place in later years and it may well have been assumed that no very great difference would result from the adoption of one or other of the procedures in paragraph 11 or paragraph 12 of Schedule 5.

However, by 1982 inflation had increased significantly and this was recognised in s. 86 of the Finance Act 1982 which provided, *inter alia*:

> (1) This section applies to any disposal of an asset -
>
> (a) which occurs on or after 6 April 1982, or, if the disposal is by a company, on or after 1 April 1982; and
>
> (b) which occurs after the expiry of the period of twelve months beginning on the date on which the asset in question was acquired or provided (which period is in the following provisions of this Chapter referred to, in relation to a disposal, as 'the qualifying period'); and
>
> (c) on which, disregarding the indexation allowance for which provision is made below, a gain would accrue (whether or not that gain would be wholly a chargeable gain).
>
> (2) In relation to a disposal to which this section applies -
>
> (a) 'the gross gain' means the amount of the gain referred to in subsection (1)(c) above, computed in accordance with Chapter II of Part II of the Capital Gains Tax Act 1979; and
>
> (b) 'relevant allowable expenditure' means, subject to subsection (3) below, any sum which, in the computation of the gross gain, was taken into

account by virtue of paragraph (a) or paragraph (b) of subsection (1) of s. 32 of that Act.

(3) In determining what sum (if any) was taken into account as mentioned in subsection (2)(b) above, account shall be taken of any provision of any enactment which, for the purpose of the computation under the said Chapter II, increases, excludes or reduces the whole or any part of any item of expenditure falling within the said s. 32 or provides for it to be written-down.

(4) The following provisions of this Chapter have effect to provide for an allowance (in those provisions referred to as 'the indexation allowance ) which on a disposal to which this section applies, is to be allowed against the gross gain so as to give the gain for the purposes of the Capital Gains Tax Act 1979 or, if the indexation allowance equals or exceeds the gross gain, so as to extinguish it; and, accordingly, at the end of subsection (1) of s. 28 of that Act (computation of gains accruing on the disposal of assets) there shall be added the words 'and ss. 86 and 87 of the Finance Act 1982'.

(5) Notwithstanding anything in s. 29 of the Capital Gains Tax Act 1979 (losses to be computed in the like manner as gains) -

(a) this section does not apply to a disposal on which a loss accrues; and ...

Section 87(2) provided for the computation of the indexation allowance in the following terms:

The indexation allowance is the aggregate of the indexed rise in each item of relevant allowable expenditure; and, in relation to any such item of expenditure the indexed rise is a sum produced by multiplying the amount of that item by a figure expressed as a decimal and determined. subject to subsections (3) and (4) below, by the formula (RD-RI) ÷ RI where -

RD is the retail prices index for the month in which the disposal occurs; and RI is the retail prices index for March 1982 or the month which is the twelfth month after that in which the expenditure was incurred, whichever is the later.

Broadly speaking the effect of the two sections was to apply an indexation allowance to the acquisition cost of an asset thereby reducing, to that extent, the gain on the disposal. It will be obvious that in general the indexation allowance appropriate to an asset acquired many years before 1982 would be of small value in relation to the subsequent gain. This was recognised by Parliament in the Finance Act 1985, first in s. 68 and, second, in Schedule 19. Section 68, so far as relevant, provided:

(1) Subject to subsection (2) below, with respect to disposals of assets on or after 6 April 1985 or, in the case of disposals by companies, 1 April 1985, the provisions of Chapter III of Part III of the Finance Act 1982 shall have effect subject to the amendments in Part I of Schedule 19 to this Act, being amendments designed -

(a) to remove the twelve month qualifying period for the indexation allowance; and

(b) to extend the indexation allowance to cases where there is a loss on a disposal; and

(c) to make provisions supplementary to those matters.

(4) For the purpose of computing the indexation allowance on a disposal of an asset to which this subsection applies where, on 31 March 1982, the asset was held by the person making the disposal, it shall be assumed that on that date the asset was sold by the person making the disposal and immediately reacquired by him at its market value on that date.

The effect of Schedule 19 may more conveniently be considered by setting out the relevant provisions of s. 86 of the Finance Act 1982 as amended:

*Indexation allowance on certain disposals*

(1) This section applies to any disposal of an asset -

(a) which occurs on or after 6 April 1982, or, if the disposal is by a company, on or after 1 April 1982; and

(b) ...

(c) ...

(2) In relation to a disposal to which this section applies -

[(a) 'the unindexed gain or loss' means the amount of the gain or loss on the disposal computed in accordance with Chapter II or Part II of the Capital Gains Tax Act 1979 and, if there is neither a gain nor a loss on the disposal as so computed, the unindexed gain or loss shall be nil]; and,

(b) 'relevant allowable expenditure' means, subject to subsection (3) below, any sum which, in the computation of the [unindexed gain or loss], was taken into account by virtue of paragraph (a) or paragraph (b) of subsection (1) of section 32 of that Act.

(3) In determining what sum (if any) was taken into account as mentioned in subsection (2)(b) above, account shall be taken of any provision of any enactment which for the purpose of the computation under the said Chapter II, increases, excludes or reduces the whole or any part of any item of expenditure falling within the said s. 32 or provides for it to be written-down.

(4) The following provisions of this Chapter have effect to provide for an allowance (in those provisions referred to as 'the indexation allowance') which, on a disposal to which this section applies, is to be [set against the unindexed gain or, as the case may be, added to the unindexed loss so as to give the gain or loss for the purposes of the Capital Gains Tax Act 1979 as follows, -

(a) if there is an unindexed gain, the indexation allowance shall be deducted from the gain and, if the allowance exceeds the unindexed gain, the excess shall constitute a loss;

(b) if there is an unindexed loss, the indexation allowance shall be added to it so as to increase the loss; and

(c) if the unindexed gain or loss is nil. there shall be a loss equal to the indexation allowance]; ...

This amending legislation achieved three undisputed results, namely:

(1) it removed the twelve month qualifying period for the indexation allowance;
(2) it extended the allowance to losses occurring on a disposal; and
(3) it applied the allowance to the market value of the asset on 31 March 1982 instead of to the acquisition cost thereof.

In the present case the taxpayer did not elect for a 6 April 1965 valuation of the furniture and the issue between the parties is whether the indexation allowance falls to be applied to the whole gain accruing between the date of acquisition and the date of disposal or only to that part which is, by paragraph 11, apportioned to the period after 6 April 1965. The Revenue contended for the former and the taxpayer for the latter. During the course of two exceptionally able arguments your Lordships were referred to numerous arithmetical examples showing the anomalies which would result from adopting one or other of the contentions. Given that straight line apportionment is an artificial method of avoiding or mitigating the effect of retrospectivity which is not necessarily related to reality, I do not find it surprising that anomalies or perhaps even bizarre results can result in either direction from its application whether alone or in conjunction with the indexation allowance. In my view the issue in this appeal must at the end of the day be determined by construction of the relevant statutory provisions viewed against the underlying philosophy of the legislation rather than by detailed consideration of hypothetical examples producing apparently anomalous results.

I have already set out the terms of s. 1(1) of the Act of 1979 and the time has come to examine in detail the provisions dealing with computation of gain. Section 28 of the Act of 1979 provided as follows:

CHAPTER II
COMPUTATION

28. (1) The amount of the gains accruing on the disposal of assets shall be computed in accordance with this Chapter, and subject to the other provisions of this Act [and ss. 86 and 87 of the Finance Act 1982].

(2) Every gain shall, except as otherwise expressly provided, be a chargeable gain.

(3) Schedule 5 to this Act (which restricts the amount of chargeable gains accruing on the disposal of assets owned on 6 April 1965) shall have effect.

The words in square brackets at the end of subsection (1) were, as has already been noted, added by s. 86 of the Finance Act 1982. Section 30 was in the following terms:

*Computation of gains*

The following provisions of this Chapter, and Schedule 5 to this Act, shall have effect for computing for the purposes of this Act the amount of a gain accruing on the disposal of an asset.

Section 32(1) identified the expenditure which was allowable as a deduction in the computation:

> (1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation under this Chapter of the gain accruing to a person on the disposal of an asset shall be restricted to -
>
> (a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him any expenditure wholly and exclusively incurred by him in providing the asset,
>
> (b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal, and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset,
>
> (c) the incidental costs to him of making the disposal.

Before the introduction of the indexation allowance in 1982 where time apportionment was relevant the computation of the gain was carried out as directed by s. 28(1) and a gain so computed became a chargeable gain for the purposes of s. 28(2) unless otherwise expressly provided. Thereafter where the asset was owned by the taxpayer on 6 April 1965 s. 28(3) directed that the provisions of Schedule 5 should have effect to restrict the chargeable gain. Time apportionment was therefore applied after the provisions of s. 32(1) had been given effect to. Section 86(4) of the Finance Act 1982 provided that the newly introduced indexation allowance was to be allowed against the gross gain which was defined by reference to subsections 2(a) and 1(c) as including a gain which might not "be wholly a chargeable gain". Subsection 4 also referred to the possibility of the indexation allowance equalling or exceeding the gross gain "so as to extinguish it". Mr. Nugee for the Revenue argued that the section in its unamended form clearly provided for the indexation allowance being applied to the gross gain before any time apportionment had taken place. Mr. Park while not conceding this did not strongly oppose Mr. Nugee's contention. I have no doubt that the contention is correct. By defining a gross gain by reference to a gain which may or may not be wholly chargeable the section necessarily contemplates that the gross gain would be determined before there had taken place any apportionment restricting the chargeable portion thereof. The reference in subsection (4) to the possibility of the indexation allowance extinguishing the gross gain points in the same direction. How then does this conclusion bear upon the 1985 legislation? Mr. Nugee contended that it was relevant in construing the amended s. 86 whereas Mr. Park contained that the Finance Act 1985 had so radically altered the basis of the indexation allowance that no guidance was to be obtained from the 1982 legislation in the interpretation of the amended s. 86.

I come now to the critical question in this appeal, namely, the construction which is to be placed upon the amended s. 86 and in particular what is meant by the words "unindexed gain" against which the indexation allowance is to be set. The Revenue contended that the unindexed gain was the gain after computation in accordance with Chapter II of Part II of the Act of 1979 but before time apportionment, whereas the taxpayer contended that computation in accordance with Chapter II included time apportionment by virtue of paragraph 11 of Schedule 5. The taxpayer submitted that the omission in the amended section of subsection 1(c) including in particular the words in parenthesis showed that it was no longer intended that the unindexed gain should be determined before time apportionment took place. This submission would necessarily involve construing the words "computed in accordance with ..." when annexed to the words "gross gain" in section 86(2)(a), as originally enacted differently from those words when annexed to the words "unindexed gain" in the amended subsections. A result which might be thought surprising but not necessarily impossible if there were compelling reasons therefor.

The definition of unindexed gain leads back to the computation provisions of Part II of the Act of 1979 of which ss. 28, 30 and 32 are

relevant for present purposes. The procedure under s. 28(1) would appear to involve a two-stage process, namely: (i) the computation of the gain in accordance with Chapter II of the Act, and (ii) the subjection of that computation to other provisions of the Act and to ss. 86 and 87 of the Finance Act 1982. In the present appeal only ss. 86 and 87 are relevant. When these two stages have been completed the result emerges as what would be a chargeable gain in accordance with s. 28(2) and only then can subsection (3) apply to restrict the amount of that potential chargeable gain in accordance with the provisions of paragraph 11 of Schedule 5. So construing s. 28, the restricting provisions of Schedule 5 play no part until after what would be the chargeable gain has been otherwise ascertained. However, s. 30 provides that Schedule 5 have effect for computing a gain. This section, argued Mr. Park, demonstrated that time apportionment under paragraph 11 was an element in computation and therefore an element that had to be taken into account in determining what was the unindexed gain against which the index allowance fell to be assessed. I was at first attracted by this argument given what I conceive to be the philosophy underlying s. 86, namely, that the indexation allowance was intended to operate as a relief against inflationary gains solely accruing after 1982. However, on further consideration I have come to the view that it is unsound. I do not consider that the reference to Schedule 5 in s. 30 embraces the whole of paragraph 11 thereof. Schedule 5 contains 18 paragraphs of which only some, such as paragraphs 2(1), 3(2) and 6(2), specifically provide for methods of computation. It is to paragraphs such as these to which the reference in s. 30 is applicable rather than to sub-paragraphs (2) and (3) of paragraph 11 which envisage that apportionment will operate upon a gain already computed thus immediately producing the chargeable gain. Mr. Park further argued that paragraph 11(8) of Schedule 5 clearly labelled time apportionment as a process of computation. This sub-paragraph relates to part disposals on or after 6 April 1965 of assets owned on that date and makes specific provision for "the computation of any gain on a subsequent disposal" by reference to time apportionment of the gain up to the date of the first disposal. However, I do not consider that the specific reference in that sub-paragraph to computation in any way alters what I conceive to be the character of sub-paragraphs of (2) and (3) of the same paragraph.

Having reached the conclusion that s. 86 in its original form required the indexation allowance to be set against the gross gain before time apportionment I consider that the terms of s. 68 of the Finance Act 1985 are signifi-cant. Subsection (1) refers to the amendments to ss. 86 and 87 of the Finance Act 1982 as being designed:

(a) to remove the 12-month qualifying period for the indexation allowance;
(b) to extend the allowance to losses; and
(c) to make provisions supplementary to those matters.

Changing the gain against which the allowance is to be set from a gross unappor-tioned gain to the apportioned part of a gross gain cannot be said to be a provision supplementary either to (a) or to (b). Such a change is not included in subsection (4) which applies to the allowance to 31 March 1982 market value nor is it provided for elsewhere in the section. This suggests that there was no intention in 1985 to alter the type of gain against which the new form of indexation allowance was to be set.

I summarise my conclusions as follows:

1. Prior to 1982 where an asset owned on 6 April 1965 was subsequently disposed of the gain was first computed by reference to the provisions of s. 32 and any other relevant provisions of the Act of 1979 and thereafter the chargeable gain resulting from this computation was restricted as a result of the application of the relevant provisions of paragraph 11 of Schedule 5.

2. When the indexation allowance was first introduced by s. 86 of the Finance Act 1982 it was set against the gross gain which was the gain computed in accordance with ss. 28(1) and (2) and 30 of the Act of 1979 subject to any other relevant statutory provisions but before the application thereto of paragraph 11(2) and (3) of Schedule 5.

3. When s. 86 was amended by the Finance Act 1985 the unindexed gain which was substituted for the gross gain continued to be computed in the same manner with

the result that the new indexation allowance fell to be set against the whole computed gain accruing from the date of acquisition and not only against that part of the gain apportioned to the period after 5 April 1965.

For the foregoing reasons I would allow the appeal.

My Lords. I reach this decision with regret because its effect is that an allowance which was given to offset the effect of inflation on gains accruing from and after 1982 is in part being attributed to notional non-chargeable gains accruing prior to 6 April 1965, a situation which cannot occur where an election of valuation on that date is made. In the present case the effective value of the indexation allowance will be reduced by more than one-third. The decision will have the same effect on losses. I should be surprised if Parliament had intended such a result. So long as the indexation allowance was set against acquisition cost the financial difference involved in adopting one or other of the two alternative constructions advanced in this appeal was likely to be small, but when the position changed in 1985 financial differences must have become much more significant. Nevertheless, neither the 1982 nor the 1985 legislation contains any provision relating specifically to the interreaction of the time apportionment and the indexation allowance although it would have been simple to deal with the matter and place it beyond doubt. Indeed, one may be forgiven for expecting that when the new allowance was introduced specific provisions for its interreaction with other provisions dealing with the computation of gains and chargeable gains would have been made. I am inclined to agree with the approach of Nolan LJ that the parliamentary draftsman may not have fully taken into account the correlation between the indexation allowance and the time apportionment formula. Certainly I have very considerable doubts whether Parliament merely by implication from prior statutory provisions intended to reduce the effective amount of an allowance given against post 1982 inflation by attributing part of it to notional gains accruing at a time before capital gains tax was in existence.

**Lord Mustill**

My Lords,

Although I share the misgivings expressed by my noble and learned friend Lord Jauncey of Tullichettle at the conclusion of his speech, I agree that for the reasons given by your Lordships, to which I cannot usefully add, this appeal should be allowed.

**Lord Woolf**

My Lords,

*The Issue*

Capital Gains Tax (CGT) was introduced by the Finance Act 1965 as from 6 April 1965. It applied to the disposal of an asset after 5 April 1965 even if the asset had been acquired prior to that date. However it was not intended that the Act should operate retrospectively so as to subject to CGT gains in the value of the asset which had already taken place prior to 6 April 1965. Accordingly when an asset was acquired prior to 6 April 1965 and disposed of after that date (the tax-payer electing not to have the gain calculated on the value of the asset at 6 April 1965) the tax-payer is entitled to have the gain on which CGT would otherwise be payable restricted so as to reflect the fact that some of the gain in the value of the asset could have occurred prior to the introduction of CGT. Although the language of the relevant legislation has changed from time to time, the manner of making that restriction has remained the same. It is by a method known as straight line apportionment ("apportionment"). In addition to apportionment a tax-payer disposing of assets after 5 April 1982, irrespective of when the assets were acquired, is entitled to an indexation allowance to reflect the inflation which has taken place since 1982.

The dispute with which this appeal is concerned is whether in determining the sum on which CGT is payable on the disposal of an asset after 6 April 1985 you make the apportionment of the sum on which CGT would otherwise be payable prior to deducting the indexation allowance or vice versa. The tax-payer says you make the apportionment first and then deduct the indexation allowance. This results in a lesser sum of CGT being

payable than if you deduct the indexation allowance prior to making the apportionment, which is the order which the Revenue says is correct. Mr. D. C. Potter QC, sitting as a Special Commissioner, decided this issue in favour of the tax-payer. Hoffmann J reversed his decision and the Court of Appeal restored the decision of Mr. Potter.

THE FACTS

This case has been chosen as the test case because the relevant facts are not in dispute and they clearly demonstrate the issue without any complicating factors. They are concisely summarised by Nolan LJ in his judgment in the Court of Appeal in terms which I gratefully adopt.

> The taxpayer, Mrs. Schofield, inherited a Chinese cabinet and a French mirror under her father's will. The combined market value of these items at the time of her father's death, which occurred on 19 April 1952, was £250. On 10 February 1987 the taxpayer sold the cabinet and the mirror at auction in London for a combined price of £15,800. The auctioneer's charges and other incidental expenses at the sale amounted to £1,462. The difference between the value of the two items on 19 April 1952 and the net proceeds of sale received by the taxpayer on 10 February 1987 was therefore £14,088.

If the Revenue are right on their argument the amount of CGT payable by Mrs. Schofield is the sum of £266.70: if she is correct there is no tax payable. So far as Mrs. Schofield is concerned the outcome of this appeal is of little practical significance. However for the Revenue the position is very different. Apparently it is estimated that over £50 million of CGT could be at stake.

THE STATUTORY PROVISIONS

Like Nolan and Beldam LJJ, I consider this dispute has to be determined by construing the relevant statutory provisions in a straightforward manner. This is not a case where it is possible to detect some clear policy on the part of Parliament making it desirable, if the language permits, to construe the legislation so as to accord with that policy. Further in order to achieve a correct resolution of the issue this is one of those situations where in accordance with Lord Diplock's speech in *IRC v. Joiner* [1975] 1 WLR at p. 1711 it is necessary to examine the statutory provisions in their historical context. When this is done it is apparent that in order to compute the amount of the chargeable gain on which CGT is payable it is necessary to calculate first what Mr. Nugee on behalf of the Revenue referred to as the entire gain, which I prefer to call the actual gain, and after that the chargeable gain on which the CGT is payable. That that is the position is not disputed by Mr. Park on behalf of the tax-payer. What he disputes is Mr. Nugee's further contention that in order to ascertain the actual gain it is necessary to deduct the indexation allowance from the entire gain and that it is only having carried out that calculation that it is necessary to make the apportionment in order to establish the part of the actual gain which is chargeable to CGT.

The history of the relevant CGT legislation can be divided into three periods. The first being from the introduction of CGT to 1982 when indexation allowance was introduced by the Finance Act 1982. The second from 1982 to 1985 when the manner of calculating the indexation allowance was substantially improved by the Finance Act 1985 and the third being after 1985. Further changes were made by the 1988 Act but they are not relevant. As the CGT provisions contained in the Finance Act 1965 were consolidated in the Capital Gains Act 1979 it is possible to concentrate primarily on the provisions of the 1979 Act and only make limited reference to the 1965 Act.

Sections 1(1) and 2(1) of 1979 Act make it clear that it is "chargeable gains" which are chargeable to CGT. Section 4(1) provides for allowable losses to be deducted from chargeable gains. It is Schedule 5, paragraph 11 which contains the provisions setting out the method of apportionment. The relevant part of the paragraph reads as follows:

> 11. (1) This paragraph applies subject to Parts I and II of this Schedule.
>
> (2) On the disposal of assets by a person whose period of ownership began before 6 April 1965 only so much of any gain accruing on the disposal as is under this paragraph to be apportioned to the period beginning with 6 April 1965 shall be a chargeable gain.
>
> (3) Subject to the following provisions of this Schedule, the gain shall be assumed to have grown at a uniform

> rate from nothing at the beginning of the period of ownership to its full amount at the time of the disposal so that, calling the part of that period before 6 April 1965, P, and the time begin-ning with 6 April 1965 and ending with the time of the disposal T, the fraction of the gain which is a chargeable gain is:
>
> $$\frac{T}{P + T}$$

In the case of Mrs. Schofield's disposal, the asset having been acquired on 19 April 1952 and sold on 10 February 1987, P is 12 11/12 months while P+T amount to 34,10/12 months. Accordingly the sum to be deducted on her calculation for apportionment is £5,224 and on the Revenue's calculation £4,259.

Other paragraphs of Schedule 5 relate to the computation of the actual gain. An example is paragraph 12 which contains the provision entitling the taxpayer to make an election for valuation of the asset at 5 April 1965. The application of Schedule 5 is dealt with by sections 28 and 30. Both sections are part of Chapter II of the 1979 Act which is headed "Computation".

Section 28 now provides (the passage in square brackets was added by the 1982 Act):

> (1) The amount of the gains accruing on the disposal of assets shall be computed in accordance with this Chapter, and subject to the other provisions of this Act [and ss. 86 and 87 of the Finance Act 1982].
>
> (2) Every gain shall, except as otherwise expressly provided, be a chargeable gain.
>
> (3) Schedule 5 to this Act (which restricts the amount of chargeable gains accruing on the disposal of assets owned on 6 April 1965) shall have effect.

Section 30 states;

> The following provisions of this Chapter, and Schedule 5 to this Act, shall have effect for computing for the purposes of this Act the amount of a gain accruing on the disposal of an asset.

Both ss. 28 and 30 figured prominently in argument. Both sides drew comfort for their contentions from the wording of the sections. Mr. Park submits that the effect of ss. 28(1) and 30 is to make the apportionment process part of the computation of the "gain " as opposed to the "chargeable gain". Mr. Nugee says, on the contrary, it is s. 28(2) which applies to apportionment since paragraph 11 expressly limits the "chargeable gain" to that "as is under this paragraph to be apportioned to the period beginning with 6 April 1965". Having regard to these rival contentions it is instructive to refer to s. 22(9) and (10) of the 1965 Act. It is those subsections which were re-enacted in different terms in s. 28 of the consolidating Act of 1979. Section 28(1) is clearly derived from s. 22(9) of the 1965 Act while s. 28(2) and (3) are derived from s. 22(10). The terms of s. 22(9) and (10) of the 1965 Act are:

> (9) The amount of the gains accruing on the disposal of assets shall be computed in accordance with Part I of Schedule 6 to this Act, and subject to the further provisions in Schedules 7 and 8 to this Act, and in this section 'capital sum" means any money or money's worth which is not excluded from the consideration taken into account in the computation under the said Part I of Schedule 6 to this Act.
>
> (10) Every gain accruing after 6 April 1965 shall, except so far as otherwise expressly provided by this Part of this Act, be a chargeable gain, but subject to the provisions of Part II of Schedule 6 to this Act (which restricts the amount of chargeable gains accruing on the disposal of assets owned on 6 April 1965).

In the 1965 Act the counterpart of paragraph 11 of Schedule 5 of the 1979 Act is in Schedule 6 Part II and so it is s. 22(10) which deals with apportionment and that subsection clearly points to apportionment operating to restrict what would otherwise be the chargeable gain. On the other hand Schedule 6 Part I largely, but not exclusively (see paragraph 14), deals with the computation of the actual gain. As it is to be presumed the later consolidating Act was not intended to change the law as contained in previous legislation the 1965 Act provides firm support for Mr. Nugee's argument.

Mr. Park's argument also focuses on sections 86 and 87 of the 1982 Act in their amended form, introduced at the beginning of the third period by the 1985 Act. Here it is useful to first consider the sections in their original unamended form in the 1982 Act. The sections set out the method of calculating the indexation allowance during the second period. Of these sections it is s. 86 which is in the

following terms which is particularly important.

(1) This section applies to any disposal of an asset -

(a) which occurs on or after 6 April 1982, or, if the disposal is by a company, on or after 1 April 1982; and

(b) which occurs after the expiry of the period of twelve months beginning on the date on which the asset in question was acquired or provided (which period is in the following provisions of this Chapter referred to, in relation to a disposal, as "the qualifying period"); and

(c) on which, disregarding the indexation for which provision is made below, a gain would accrue (whether or not that gain would be wholly a chargeable gain).

(2) In relation to a disposal to which this section applies -

(a) "the gross gain" means the amount of the gain referred to in subsection (1)(c) above, computed in accordance with Chapter II of Part II of the Capital Gains Tax Act 1979; and

(b) "relevant allowable expenditure" means, subject to subsection (3) below, any sum which, in the computation of the gross gain, was taken into account by virtue of paragraph (a) or paragraph (b) of subsection (1) of s. 32 of that Act.

(3) In determining what sum (if any) was taken into account as mentioned in subsection (2)(b) above, account shall be taken of any provision of any enactment which, for the purpose of the computation under the said Chapter II, increases, excludes or reduces the whole or any part of any item of expenditure falling within the said s. 32 or provides for it to be written-down.

(4) The following provisions of this Chapter have effect to provide for an allowance (in those provisions referred to as "the indexation allowance") which, on a disposal to which this section applies, is to be allowed against the gross gain so as to give the gain for the purposes of the Capital Gains Tax Act 1979 or, if the indexation allowance equals or exceeds the gross gain, so as to extinguish it; and, accordingly, at the end of subsection (1) of s. 28 of that Act (computation of gains accruing on the disposal of assets) there shall be added the words 'and ss. 86 and 87 of the Finance Act 1982'.

The language of s. 86 with its references to "gross gain" clearly makes the deduction of the indexation allowance part of the first computation, that is ascertaining the actual or gross gain. Mr. Park was not prepared to concede that this was inevitably the position but with his usual sense of responsibility he was not prepared to argue the contrary. If s. 86 had not been amended it would therefore have been conclusive in the Revenue's favour. However s. 86 was substantially amended and Mr. Park submits it is the amended form of the section which has changed the situation. The section in its amended form is in the following terms:

(1) This section applies to any disposal of an asset -

(a) which occurs on or after 6 April 1982, or, if the disposal is by a company, on or after 1 April 1982; ...

(2) In relation to a disposal to which this section applies -

(a) 'the unindexed gain or loss' means the amount of the gain or loss on the disposal computed in accordance with Chapter II of Part II of the Capital Gains Tax Act 1979 and, if there is neither a gain nor a loss on the disposal as so computed, the unindexed gain or loss shall be nil; and

(b) "relevant allowable expenditure" means, subject to subsection (3) below, any sum which, in the computation of the unindexed gain or loss, was taken into account by virtue of paragraph (a) or paragraph (b) of subsection (1) of s. 32 of that Act.

(3) In determining what sum (if any) was taken into account as mentioned in subsection (2) (b) above, account shall be taken of any provision of any enactment which, for the purpose of the computation under the said Chapter II, increases, excludes or reduces the whole or any part of any item of expenditure falling within the said section 32 or provides for it to be written-down.

(4) The following provisions of this Chapter have effect to provide for an allowance (in those provisions referred to as "the indexation allowance") which, on a disposal to which this section applies, is to be set against the unindexed gain or, as the case may be, added to the unindexed loss so as

to give the gain or loss for the purposes of the Capital Gains Tax Act 1979 as follows, -

(a) if there is an unindexed gain, the indexation allowance shall be deducted from the gain and, if the allowance exceeds the unindexed gain, the excess shall constitute a loss;

(b) if there is an unindexed loss, the indexation allowance shall be added to it so as to increase the loss; and

(c) if the unindexed gain or loss is nil, there shall be a loss equal to the indexation allowance; ...

(5) ...

(6) The provisions of Schedule 13 to this Act have effect for supplementing this section and the following provisions of this Chapter and the preceding provisions of this section have effect subject to the provisions of that Schedule.

The references to "gross gain" as a result of the amendment have now disappeared and Mr. Park submits they must have been deliberately omitted. He also relies on the deletion of section 86 (1)(c). He stresses the scale of the changes made by the 1985 Act. In particular he stresses the fact that during the second period indexation was only allowed against the original acquisition cost which if the asset had been owned for a substantial period could make the allowance for inflation wholly unrealistic. (Section 68(4) of the 1985 Act rectified that position by allowing indexation relief against the 1982 value.) Mr. Park argues that when legislation has been amended to this substantial extent its meaning should be derived from its language as amended and not by examining the provisions prior to the amendment. This is very much the approach adopted by the Court of Appeal, the Judge and Mr. Potter. In his judgment [1992] 1 WLR Nolan LJ said, at p. 649C:

> It seems to me. as it did to the judge and to the commissioner, that the provisions of the Act of 1982 were too radically altered by the provisions of the Act of 1985 for the language of the former to be taken as a Guide to the meaning of the latter.

If it had not been for the terms of s. 68(1) which I suspect did not figure prominently in the argument below as it is not cited in the judgments I would consider this approach had considerable force. However. s. 68(1) of the 1985 Act sets out the precise purpose of the amendments to s. 86 of the Finance Act 1982 and those purposes are not consistent with Mr. Park's argument. What s. 68(1) states so far as relevant is:

> ... the provisions of Chapter III of Part III of the Finance Act 1982 shall have effect subject to the amendments in Part I of Schedule 19 to this Act, being amendments designed -
>
> (a) to remove the twelve month qualifying period for the indexation allowance: and
>
> (b) to extend the indexation allowance to cases where there is a loss on a disposal; and
>
> (c) to make provisions supplementary to those matters.

Section 86 is in Chapter III of Part 111 of the Finance 1982 and Schedule 19 Part I to the 1985 Act sets out the amendments to s. 86 of the 1982 Act. Clearly the reversal of the order of deducting the indexation allowance and apportionment do not fall within these specified purposes.

## CONCLUSION

On the language of the statutes I therefore accept that the approach of the Revenue is correct. Mr. Nugee did however have other arguments which he deployed with enthusiasm in support of the Revenue's appeal. He argued that the tax-payer's approach just did not work in relation to certain provisions of the CGT legislation. He submitted that it operated in a manner which was unduly favourable to the taxpayer. Graphs were relied on to demonstrate these points. He submitted the legislation did not use the word "gain" when it meant "chargeable gain". Mr. Park argued equally vehemently to the contrary. He cited provisions where he submitted the word "gain" was being used to include 'chargeable gains" and he sought to demonstrate how the interpretation for which he was contending worked perfectly satisfactorily He relied strongly on the fact, which is correct, that if the Revenue's approach is adopted this results in the indexation allowance being reduced. As the issue which divides the parties can be resolved perfectly satisfactorily on the language of the statutory provisions I do not propose to do more than indicate that while I do not by any means accept all the Revenue's arguments I am

prepared to acknowledge that despite Mr. Park's contentions there is force in the following two points:

(1) The rate of inflation in the 1980s was higher than it had been previously. This meant that the value of most assets would have increased more rapidly post 1982 than they had prior to 1965. The greater the rate of the increase in value of an asset after 1965 the greater is the advantage of apportionment to the taxpayer since by treating the value as increasing on a straight line basis the taxpayer has the benefit of the notional value at 6 April 1965 being higher than in fact it would have been.

(2) As apportionment is designed to compensate the taxpayer for a gain which could have occurred in value prior to 1965 and the indexation allowance only operates post 1982 the taxpayer is not being unfairly treated if it is not only his gain post 1982 which is apportioned but it is also his indexation allowance on that gain.

I do however emphasise that I do not decide this appeal on these points and it is based on my interpretation of the legislation that I would allow the appeal. This means that the question raised for the opinion of the High Court (see [19901 1 WLR at p. 1448? should be answered in the manner contended for by the Crown.

***Reported by Shamsiah Begum Subhan.***